IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

WEALTH TAX REFERENCE No 6 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF WEALTH-TAX

Versus

LALLUBHAI GORDHANDAS CHARITABLE TRUST

Appearance:

MR MIHIR JOSHI with MR MANISH R BHATT for Petitioner

MR JP SHAH with MR MANISH SHAH, Advocates for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE A.R.DAVE

Date of decision: 23/09/98

ORAL JUDGEMENT (Per R.K.Abichandani,J.)

The Income Tax Appellate Tribunal has referred the following question at the instance of the Revenue, for the opinion of this Court, under Section 27(1) of the Wealth Tax Act, 1957.

"Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee was entitled for exemption under Section 5(1)(i) of the Wealth Tax Act, 1957?"

2. The assessee is a Trust, which claimed that the wealth of the Trust was exempt under Section 5(1)(i) of the Wealth Tax Act, 1957 for the Assessment Year 1973-74. The Wealth Tax Officer, by his order dated 22.12.1978, held that the total shares issued by Messrs C.Doctor and Company Private Limited, in which the Trust had made investment, were 675 out of which the assessee Trust held 165 shares. It was held that the entire share-holding of the company was held by the trustee and their relatives and hence, in view of the provisions of Section 21A of the said Act, the Trust was not entitled to the exemption granted under Section 5(1)(i) of the Act. The WTO held that similar was the position with the investment in the other company known as Messrs Mehta Corporation Private Limited. The contention raised by the assessee was that by virtue of second proviso to Section 21A of the Act, it did not lose the entire exemption, but the exemption could be denied only to funds invested with these companies, because, the investment was less than five per cent of the total investment of these companies. The WTO negatived the claim of the assessee, holding that the meaning attributed to the word "capital" by the assessee was misleading and that capital in the normal sense means, the surplus of assets over the liabilities and not the assets, and in relation to a company, it means the subscribed capital and nothing else. Against the order of the WTO rejecting the claim of the assessee Trust, an appeal was carried to the CWT (Appeals) and by it's order dated 14th October, 1980, the CWT (Appeals) held that in view of the finding of the Income Tax Appellate Tribunal while dealing with the Income Tax Appeal in respect of the Assessment Year 1972-73 that the aggregate funds of the Trust invested in the companies did not exceed five per cent of the capital of the concern and that therefore, the income of the Trust was required to be exempted under Section 11 of the Income Tax Act, even for the purposes of Wealth-tax, the exemption under Section 5(1)(i) of the said Act could not be denied by invoking the provisions of Section 21A of the Act. The assessee's appeal for the said Assessment Year 1973-74 was therefore, accordingly allowed. The Wealth Tax Officer challenged that decision before the Income Tax Appellate Tribunal and the Tribunal, by it's order dated 24th September, 1981, dismissed the appeal, holding that the

CWT (Appeals) had only followed the decision of the Tribunal in the Income Tax proceedings, wherein it was held that the funds of the Trust invested in the companies did not exceed five per cent of the capital. Alongwith the statement of case, besides forwarding the relevant orders in respect of the proceedings under the Wealth Tax Act, the Tribunal also has forwarded it's decision in Income Tax Appeals in respect of the years 1971-72 and 1972-73, rendered on 28th February, 1978, which was relied upon by the CWT and the Tribunal for holding in favour of the assessee.

The Tribunal in it's order dated 28.2.1978 in assessee's own case arising in context of the exemption that assessee claimed under Section 11 of the Income Tax Act, took note of the fact that the assessee Trust had invested it's fund with Messrs C. Doctor and Company Private Limited and Messrs Mehta Corporation Private Limited and that the Income Tax Officer had treated the entire income of the Trust as taxable because in his view the investments of the Trust in these Private Limited Companies exceeded five per cent of the capital of the companies and that the relatives of the trustees were substantially interested, disentitling the assessee to get the benefit of Section 11 of the Income Tax Act. The Tribunal, considering the provisions of Section 13(4) of the Income Tax Act, concluded that the capital of the concern could be much larger than the capital of the property of the business and that capital of a concern within the meaning of Section 13(4) of the Act would include even borrowed money employed as capital in the concern. The contention of the assessee in fact was that the capital as mentioned in Section 13(4) of the Income Tax Act, should be construed to mean not only the paid-up capital of the company in which the funds of the Trust were invested, but also the reserves and that if the reserves were taken in to consideration, the investments of the assessee Trust in the said companies did not exceed five per cent of their total capital. The Tribunal held that as in Section 80J of the Income Tax Act, even in Section 13(4) thereof, the capital of a business or concern was distinct or different from the capital of a person who may be interested in the business or may even be the Proprietor of the concern. It was held that the exemption under Section 11 of the Act could not be denied to the assessee on the ground that it was not available because the aggregate funds that it had invested in the concern exceeded five per cent of the capital of the concern.

This decision of the Tribunal given in context of

the provisions of Section 11 read with 13(4) of the Income Tax Act came to be challenged in a reference at the instance of the Revenue before this Court, and this Court, by it's decision in CIT Vs. L.G.Mehta Charitable Trust, reported in 207 ITR 104, held that the Tribunal erred in holding that the aggregate funds of the assessee Trust invested in the concerns did not exceed five per cent of the capital of that concern. In the process, this Court held that in a case of a company, capital would ordinarily mean share capital and Sections 85 and 86 of the Companies Act make that position clear. If shares are issued at a premium, then the amount of premium received by the company may be regarded as capital, but the Court was not concerned in this case with such a situation. It was held that in view of this clear position under the Companies Act, it was difficult to accept the contention raised on behalf of the assessee that the word "capital" in Section 13(4) of the Act in the case of a company would also include it's reserves. It was observed that no other provision of law or any authority was pointed out to show that the reserve of the company is regarded as it's capital. Thus, in view of the judgement of this Court in the said reference arising out of income-tax proceedings in assessee's own case, which was in respect of the assessment year 1972-73 and in context of the same investment made by the assessee in Messrs C. Doctor and Company Private Limited and Messrs Mehta Corporation Private Limited, the very basis on which the Tribunal decided the matter arising under the Wealth Tax Act in favour of the assessee by holding that the funds of the Trust invested did not exceed five per cent of the capital of these concerns having vanished, the holding of the Tribunal in the present case that the assessee was entitled for exemption under Section 5(1)(i) of the Wealth Tax Act, 1957 became obviously wrong and this should have been enough for us for answering the question against the assessee.

The learned Counsel appearing for the assessee has however, tried to persuade us to a view contrary to the one taken in assessee's own case by this Court in a reference arising out of income tax proceedings, in respect of the same assessment year by contending that several important aspects were not argued on behalf of the assessee in that reference and he submitted that the matter ought to be referred to the Full Bench, if we are persuaded to take a different view of the matter. It was contended that there was no reason for giving a narrow meaning to the word "capital" and the word "capital of a concern" would include the reserves. Placing reliance on the decision of the Supreme Court in Metal Box Company

Vs. Their Workmen, reported in 73 ITR at page 53, it was contended that the reserves are appropriations of profits and the assets by which they are represented being retained to form part of the capital employed in the business, should be treated as capital. Relying upon the meaning of word "capital" from dictionaries, the Counsel contended that any money received by a company or a benefit which enables it to carry on its business must be considered as its capital. He relied upon the decision in Municipal Council of Visakhapatanam Vs. Tea District Labour Association (1932) 2 Company Cases 213 in support of his contention and also referred to Venkataramaiya's Law Lexicon & Legal Maxims (Second Edition - 1980) Vol.1 wherein at page 341 it is described that any money received by a company is a benefit and that society or an association which enables it to carry on its business must necessarily be capital. He submitted that reserve being appropriation of profits retained to form part of the capital employed in the business, must be considered capital of a company. Reliance was also placed by the learned Counsel for the assessee on the decision of the Hon'ble Supreme Court in the case of Lohiya Machines Ltd. and anr. Vs. Union of India, reported in 152 ITR 308, in which, in context of the provisions of Section 80J(1) of the Income Tax Act, 1961 and Rules 19 and 19A of the Rules framed thereunder and other relevant provisions, it was held that expression "capital employed" was not a term of art nor was it an expression having a fixed connotation or meaning, but it was susceptible of varied meanings, including or excluding short term borrowings or long term borrowings whether of all categories or of any particular category or categories depending on its environmental context. The Supreme Court held that Rule 19A of the Income Tax Rules, in so far as it excluded borrowed monies and debts in the computation of the capital employed and provided for the computation of the capital employed as on the first day of computation period, was not ultra-vires Section 80J of the Act and was a valid Rule.

3. The learned Counsel appearing for the Revenue contended that capital of a concern in context of a company would mean only share capital and cannot include reserves. He submitted that reserves were undistributed profits which could have been declared as dividend, but were not in the discretion of the Board of Directors and unless especially capitalised, they are not monies of the members risked in the business and therefore, not capital. He submitted that the decision of this Court in the assessee's own case - CIT Vs. L.G.Mehta Charitable Trust, reported in 207 ITR 104 ought to be followed even

in the present case.

4. Under Section 5(1)(i) of the said Act, it is provided that wealth-tax shall not be payable by an assessee in respect of any property held by him under trust or other legal obligation for any public purpose of a charitable or religious nature in India. Section 21A of the said Act, inter-alia, provided that notwithstanding anything contained in Clause (i) of sub-section (1) of Section 5, where any property is held under trust for any public purpose of a charitable or religious nature in India, any part of such property or the income of the trust is used or any part of the income of the trust created on or after 1st April, 1962 enures for the benefit of any person referred to in sub-section (3) of Section 13 of the Income Tax Act, wealth-tax shall be leviable upon and recoverable from the trustee or manager in the like manner and to the same extent as if the property was held by an individual who is a citizen of India and resident in India for the purposes of the Act at the rates specified therein. Under the Second proviso to Section 21A, it has been laid down that in a case where the aggregate of the funds of the trust invested in a concern, in which any person referred to in sub-section (3) of Section 13 of the Income Tax Act, has a substantial interest as provided in Explanation (3) to that Section, does not exceed five per cent of the capital of that concern, the exemption under Clause (i) of sub-section (1) of Section 5 shall not be denied in relation to any property other than such investment, by reason only that the funds of the trust have been invested in a concern in which any person referred to in sub-section (3) of Section 13 of the Income Tax Act, has such substantial interest. The Second proviso is similar to the provisions of Section 13(4) of the Income Tax Act. Explanation (3) to Section 13 of the Income Tax Act provided that for the purpose of that Section, a person shall be deemed to have a substantial interest in a concern where it is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to in sub-section (3) of Section 13 of the Act.

5. So far as the assessee is concerned, there is no dispute that persons of the category falling in sub-section (3) of Section 13 of the Income Tax Act did have substantial interest in the said two Private Limited

companies. The only question which was therefore, agitated was whether the aggregate of the funds of the assessee trust invested in these two companies did not exceed five per cent of the capital of those companies and for that purpose whether the word "capital" would include within its meaning the reserves, borrowed capital etc. in which event the funds invested will fall short of five per cent of the capital of the two companies.

6. (i) The expression "capital of that concern" which occurs in the Second proviso to Section 21A is intended to take within its sweep all the types of concerns in which the trust could invest its funds. The word "capital" will therefore, take colour from the type of concern to which it is applied. We may recall here what Chitty, J. said in Lubbock V. British Bank of South America (1892) 2 Ch. 198 at page 202:

> "A man's business is to make boots and shoes. He has Pounds 10,000 which he takes into that business as his capital. He makes boots and shoes, and spends the whole of his Pounds 10,000 in doing it, and he sells and gets back from his customers a certain sum on the sale. He compares then, assuming he has sold all, what he has got back with his expenditure in producing the boots and shoes, and putting them on the market, and if he finds he has his Pounds 10,000 (I am treating it apart from any question of debts outstanding, supposing it is a good solid sale) then his capital is intact, and the rest, if there is a rest remaining in his hands, is profit. On the other hand, if he has only Pounds 9000, his capital is not intact, and he has lost. It is exactly the same principle that has to be applied to a trading company under the Companies Act, and the capital that has to be regarded for the purpose of the Act of Parliament is the capital according to the Act and not the things, whether houses, goods, boots and shoes, or hats, or whatever it may be for the time being representing the capital, in the sense of being things in which the capital has been laid out."

(ii) In context of a Partnership concern, by the capital of a Partnership is meant the aggregate of the sums contributed by the partners for the purpose of commencing or carrying on the partnership business and intended to be risked by them in that business. The

capital of a partnership is therefore, not the same thing as its assets which may vary from day-to-day and would include everything belonging to the firm, which has money value. There is a fundamental distinction between a firm's capital on one hand and its assets, often called "capital assets" on the other. That distinction is critical to an understanding of the true nature of capital. Where a partner brings in the asset and is credited with its "capital" value in the firm's books, the asset as such will cease to be his property and will thereafter, belong to the firm. That partner's capital will thereafter be unaffected by fluctuations in the value of the asset, which will represent capital profits or losses potentially divisible between the partners in their capital profit sharing ratios. (See Lindley & Banks on Partnership, Sixteenth Edition (1990) at page 422).

(iii) When the concern is a company registered under the Companies Act, 1956, the word "capital" will have to be understood in context of the provisions of that Act. As provided by Section 13(4) of the Companies Act, in the case of a company having a share capital, the memorandum shall state the amount of share capital with which the company is to be registered and the division thereof in to the shares of a fixed amount. The word "capital" is used in Company Law in various senses, but it is properly used to denote the share capital of a company. The nominal capital of a company sets the limit of capital available for issue and therefore, the issued capital of a company, cannot exceed that limit. The nominal capital is, strictly speaking not capital at all, since it is only an authority by the share-holders to the directors to create new capital by the issue of shares. The issued capital is on the other hand a reality and not a mere authority to create new capital. The nominal capital must be stated in the memorandum of association and would be equal to nominal value of shares which the directors are authorised to issue. The alteration in the actual value of shares as contrasted with the nominal, does not affect the amount of issued capital and this would apply to the whole concept of share capital in whatever sense that term is used. (See Palmer's Company Law - Vol.1 Twentyfifth edition (1992) Part 4 at 4.001, 4.002 and 4.003).

(iv) As observed by Megarry J. in Canada Safeway Limited Vs. Inland Revenue Commissioners (1973) 1 Ch. 374 at 380, the capital of a company may remain wholly unchanged while estimates of the value of the company's assets or its undertaking or its shares fluctuate greatly

on the stock exchange and elsewhere.

(v) A company which has a balance to the credit of its profit and loss account is not bound to apply that sum in making good an estimated deficiency in value of its capital asset. It may carry it to a suspense account or to reserve, and if the assets subsequently increase in value the amount neither has been nor will be part of the capital. If, therefore, a part of that balance is being used in paying a dividend, that dividend is not paid out of such capital, because such sum never became capital (Farwell.J in Bond V. Barrow Haematite Steel Co. [1902] 1 Ch. 353 at 364, 365.)

(vi) A reserve fund would be a fund which at the time at which it was created arose from the fact that there were available assets (after deducting all liabilities of every kind, including the amount which is represented by the share capital) which might have been applied as the company thought fit without thereby doing any violence to the provisions of the Companies Acts or to the memorandum and articles of the company. The surplus carried to the reserve fund represented that which could have been used in paying further dividends to the share-holders. The reserve fund created could subsequently be dealt with by the company as per the provisions of its memorandum and articles either by utilising it by equalising dividends or making good lost capital, or any other purpose as the company may think fit within its objects. Such reserve fund would in no way represent the capital account properly so-called. The company could take assets representing such reserve fund keeping the assets wholly apart from all the other accounts of the company. Therefore, a reserve fund could not be properly called in itself a capital. The capital account properly so called is a share capital of a company. (See In re Hoare & Co., Limited and Reduced (1904) 2.Ch. 208 at pgs. 213 and 214 - Romer L. J.).

7. The capital of a company therefore, would in our view mean share capital in context of the provisions of the Second proviso to Section 21A of the said Act and the meaning of the word "capital" cannot be made mercurial by attaching it to all the assets that the company may own, nor can it include the reserves of the company, which can at any subsequent time be distributed as dividend. The expression "capital employed" stands on a different footing in context of the provisions of Section 80J of the Income Tax Act, read with Rule 19A of the Rules framed thereunder and cannot be projected in the expression "capital of that concern" occurring in the

Second proviso to Section 21A of the Act, the purpose underlying the provisions of Section 80J being entirely different from the object sought to be achieved by the provisions of the Second Proviso to Section 21A of the said Act, and for that matter even the provisions of Section 13(4) of the Income Tax Act.

8. We are therefore, unable to persuade ourselves in to referring the matter to a larger Bench, as the learned Counsel for the assessee would have liked us to do on the basis of his contentions. In fact, we find that all the above reasons which we have given are underlying what the Division Bench has already held in assessee's own case, reported in 207 ITR 104 and we have only made explicit what was implicit in the ratio of that decision. We reaffirm the ratio of that decision and respectfully agree with it.

9. For the reasons that we have given above, we hold that the Tribunal committed an error in holding that the assessee was entitled for an exemption under Section 5(1)(i) of the said Act and the question referred to us is therefore, answered in the negative in favour of the Revenue and against the assessee. The reference stands disposed of accordingly with no order as to costs.

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